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Privatization and Restructuring of Serbian Economy Real and Banking Sector*

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ABSTRACT - The real sector Serbian economy process of privatization has not been completed after 18 years of implementation. Nevertheless, the privatization (and restructuring) of socially owned enterprises is one of the key requirements for enhancing business performances of the real sector and entire economy. Although relatively satisfactory results of key macro economic trends in Serbia have been realized in previous period, it could not be stated that all desired and expected effects have been efficiently realized up to now. As a result, according to the World Economic Forum Report, the Serbian economy is at 91 place among 130 countries on the level of competitiveness. Partly, it's a result of unsatisfactory trends in the field of real sector privatization and restructuring. On the other side, during transition period after the year 2000, the banking sector in Serbia has been transformed and revitalized. The main weaknesses of banking system in the period before 2000. (illiquidity and general insolvency, the lack of confidence towards financial institutions, the lack of stable deposit bank, etc.) have been overcome. In the last few years most of domestic commercial banks are privatized by foreign ones, and consequently the banking sector became profitable, liquid and highly capitalized. The trends, resulting from the increased competitiveness and efficiency of banking sector, are confirming the benefits of banking sector restructuring and have positive impact on local economy.

KEY WORDS: Serbian economy, privatization, restructuring, real sector, banking sector

Introduction

Numerous changes, immanent to the process of transition, progress in Serbia with slower than desired pace. Among them is the privatization and restructuring of enterprises, which have the key importance for economic activities performances improvement and change in economic structure. While the majority of countries of Central and Eastern Europe has already carried out the privatization, improved significantly business environment and quality of socio-economic activities (and joined EU or are about to be joined to EU), Serbia is still lagging behind in real sector economy transformation.

On the other side, much better results have been achieved in banking sector transformation. After democratic changes in the year 2000, followed by restructuring and bankruptcy of few banks, bank market is liberalized and opened to foreign investors. Foreign banks penetrated Serbian market, either by establishing the new banks, or by taking over the existing domestic banks, resulting ownership structure of Serbian banking sector to be predominantly foreign owned.

After more than seven years of the banking sector restructuring, it is obvious that domestic banks are less competitive than foreign ones, particularly in two aspects: access to international capital markets and domestic deposits. Having in mind that banking sector privatisation and restructuring process is not finished, is likely that ownership structure will change slightly in favor of foreign banks.

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The results of privatization of the real sector of the economy of Serbia

In Serbia, not even after 18 years of implementing privatization, according to several different basic models and laws, this process has not been successfully completed!

By the current Law on Privatization, it is determined that the process of privatization of socially owned enterprises, which had begun even in the year 1990, should be finished by the end of 2008. However, within the portfolio of Agency of privatization, in the November 2008, were more than 900 socially owned non-privatized firms (among them 72 in the process of tender privatization and 47 in the process of privatization through restructuring). In addition to that, there are a great number of stocks socially owned enterprises within Share fund. Furthermore, the privatization of public state enterprises, on republic and local level, has not even practically started. Among them are 17 large public state enterprises that employ more than 100 thousands employees (or some 10% of total labor force) and realize some 17% of total economy revenues.

The process of the real sector of the economy privatization has been intensified in Serbia after the democratic changes (in fact since the beginning of 2001.) along with the implementation of intensive transitional reforms. In period from 2002 up to June 2008. the following results have been achieved:

Table 1. Results in the process privatization real sector of Serbia in period 2002-June 2008.

	Tenders	Auctions	Share Fund	Total
Number of privatized enterprises	93	1 591	515	2 189
Number of employees in privatized enterprises	79 772	144 579	110 897	335 247
Privatization revenues (in mil €)	1 145.2	1 089.8	497.6	2 732.6
Total investment in privatized enterprises (u mil EUR)	998.1	221.7	5.9	1 225.7
Redundancy programme (u mil EUR)	276.7	-	-	276.7

Source: Bulletin of Public Finances of the Republic of Serbia

It is noticeable that very significant share of up to now privatization revenues (around 43%) was realized in 2002 and 2003. Namely, efforts in privatization were initially directed to the most attractive parts of the economy (tobacco industry, cement, beer, medicines, rubber, construction materials, then sugar refineries, chemical industry, oil derivatives distribution...) and successful enterprises. Concerning the attractiveness of these enterprises (large market and/or significant property), a greater number of investors were interested in buying them, which influenced on the results in privatization to be initially very favorable. With the privatization of only 14 most attractive enterprises in 2002 and 2003, the revenue of around €869 millions or somewhat more than 30% of total realized privatization revenues.

However in 2004, a certain slowdown became evident in privatization in the real sector of the economy of Serbia. To a significant extent this was caused by the fact that the corpus of enterprises attractive for privatization was noticeable decreased, i.e. that some market attractive public enterprises have not entered the privatization process. At the same time, for majority of remaining "business controversial" enterprises in difficulties and problems, there was no great interest from potential investors. Considering an immense number of these enterprises, a question was imposed in which method to access to the privatization and transforming of enterprises, which can very hardly find new owners.

For those reasons, by the middle of 2005, do amendments of the Law on Privatization were introduced. By the Amendments of the Law on privatization, basically, the government (and public enterprises) has written off their debts towards non-privatized enterprises. In that way, indebtedness has been reduced considerably and remaining socially owned enterprises have been made more attractive to potential investors. That has put revenues from the sale of enterprise and their support to the budget of Serbia into the second plan, and the priority was given to speeding up and finishing the process of privatization. Besides, the government has taken over to itself financing the redundancy, with which a great number of enterprises burdened by enormous of employees in relation to current production and market possibilities, has been made more attractive for potential buyers.

By these legal changes a new incentive was given to the process of privatization. In 2005, 189 enterprises were sold by auction privatization, with around 20 thousand employees, and revenue of €156.5 million was realized. Through tender privatization 13 enterprises were sold, with around 8.0 thousand employees, and revenue of €96.4 million was realized. In 2005 activities in sale of minority packages were intensified and Share Fund of the Republic of Serbia realized the best results in number of sold shares of the companies (more than 132) as well as in financial result (more than €124,8 million). All that indicates to certain acceleration of the process of privatization compared to previous year.

In 2006, 184 enterprises were sold by auction privatization, with around 18 thousand employees, and revenue of €147.6 million was realized. Through tender privatization 22 enterprises were sold, with around 19.9 thousand employees, and revenue of €99.8 million was realized. In 2006. Share Fund of the Republic of Serbia sold shares of the 78 companies for €67.7 million.

In 2007, 272 enterprises were sold by auction, with around 26.2 thousand employees, and revenue of €341.8 million was realized. Through tender privatization 17 enterprises were sold, with around 14.6 thousand employees, and revenue of €123.6 million was realized. In 2007 Share Fund of the Republic of Serbia sold shares of the 76 companies for €77.2 million.

In the field of privatization through restructuring, modest results were realized until 2005. Through processes of financial and organizational restructuring (mainly fragmentation of enterprises), the government i.e. the Privatization Agency has been trying to prepare a certain number of once large and/or significant enterprises for local self-government for privatization and more successful business operating in forthcoming period. Unfortunately, in around 70 economic entities that have initially been in the process of restructuring, until the alteration of the Law on Privatization in 2005, this process was implemented in a small number of enterprises ("Livnica" Kikinda, "Sever" Subotica, parts of other enterprises, like "Zmaj" Zemun, etc.). Therefore, visible effects of implemented processes of restructuring to total business operating of domestic economy were not noticeable.

After the amendment of the Law on Privatization (since 2005), visible moves in restructuring field were realized, and some big enterprises were privatized, like "Azotara" pančevo, "FVK" Kraljevo, "Hisar" Prokuplje, "Nitex" niš, "Partizanski put" Beograd, "Hipol" Odžaci, etc. Reducing indebtedness and number of employees, as well as stabilization of total economic ambient are key reasons that influenced on adding dynamics to the process of restructuring of the real sector of the economy of Serbia since 2005. However, the achieved results are still inadequate and energetic actions are needed.

According to the EBRD estimates the level of transition indicators for Serbia in the field of privatization is constantly improving since 2001. The EBRD in Transition report 2008 do not estimate the results of large-scale privatization and enterprise restructuring very highly, even in comparison to other countries of former Yugoslavia. On the other hand the results of small-scale privatization are estimated much better:

Table 2. Transition indicators in privatization and banking sector of Serbian economy *

Year	Large scale privatization	Small scale privatization	Enterprise restructuring
2001	1,00	3,00	1,00
2002	2,00	3,00	2,00
2003	2,33	3,00	2,00
2004	2,33	3,33	2,00
2005	2,67	3,33	2,33
2006	2,67	3,67	2,33
2007	2,67	3,67	2,33

Source: EBRD, *Transition EBRD report 2008*

(*The measurement scale for the indicators ranges from one to 4+, where one represents little or no change from a rigid centrally planned economy and 4+ represent the standards of an industrialized market economy).

Problems and opposing to changes in privatization and restructuring real sector process

The process of privatization of the real sector of Serbia has been followed by numerous opposing and problems. The problem of opposing to changes often presents the main obstacle to successful privatization and restructuring process, and the most often leads to significant dragging out in implementation of necessary changes. Opposing is present when a concept of implementing changes is concerned, as well as proposed implementation method. Namely, changes affect the management and employees, that is, their positions, responsibilities and existing forms of behavior. Therefore the majority of employees, including their managers too, not only are not interested in changes, but also with hostile attitude towards them. There is no readiness in the management to enter into the privatization and restructuring, i.e. alter the gloomy present of business operating of their enterprises "with uncertain", maybe even better future. Instead of working on enabling their enterprise for business activities in completely different conditions of business operating, efforts of management are still significantly directed to keeping old-fashioned methods of business operating (not rarely based on renting capacities to private entrepreneurs) or to searching for different aspects support from the government. Besides all that, it is not rare a domination of temporary private interest of some managers over the interests of the whole enterprise and the employed in them.

Unfortunately, neither the employees are too much interested in the privatization and restructuring, because they do not see direct interest in that. In addition, the majority of the employed is very scared for their work posts and wages and opposes to strategic changes due to fear from future, although they are unsatisfied with their current status as well.

The processes of privatization through restructuring, especially of large enterprises of the real sector of Serbia are burdened by substantial business problems. Although great differences exist from an enterprise to an enterprise, numerous mutual problems are characteristic for all these enterprises, which cannot be systematized to presented SWOT matrix.

Table 3. SWOT matrix of large non-privatized enterprises in difficulties

Strengths	Weaknesses
<ul style="list-style-type: none"> ▪ Long tradition and production experience ▪ Experienced and trained labor force ▪ Large surface of land and building facilities ▪ Significant production capacities 	<ul style="list-style-type: none"> ▪ Lack of profitability ▪ High indebtedness and chronic lack of own working capital ▪ Out of date production equipment and technology ▪ Old-fashioned production programme and lack of marketing concept ▪ Surplus of employees, inadequate qualification and age structure of employees ▪ High fixed costs and non-competitiveness ▪ Property-legal relations ▪ Numerous court disputes
Opportunities	Threats
<ul style="list-style-type: none"> ▪ Written off debts through financial restructuring ▪ Implementation of redundancy programmes ▪ Investments in state-of-the-art production technologies and products development after privatization ▪ Possibilities for increase of sale on domestic and European market through privatization by strategic partners 	<ul style="list-style-type: none"> ▪ Intensification of competition by smaller private domestic and big foreign producers ▪ Liberalization of import regulations ▪ Non-understanding of creditors for existing situation ▪ Inefficient legal system ▪ Political instability

Numerous controversies related to new owners and their behavior form is also a significant problem of privatization in Serbia. In a certain number of enterprises, the privatization was mainly motivated by speculative reasons, in the first place by the acquisition of property that those socially owned enterprises possessed. Therefore, new owners and management are not interested in enhancement of the business performances, but to buy (and sell) the property. The new owners frequently create conditions, with different measures (before all low wages and introducing rigorous working discipline), for employees to give notice and leave enterprises (in spite of social programme of adopted plan). In these cases the existing property remains on disposal of new owners, which they offer after the term anticipated by law (related to a ban of alienation of privatized enterprises' property) for sale on the market (probably at considerably higher prices in comparison to those at which they had bought the capital of those enterprises).

A number of "annulated privatizations" in which purchase contracts were cancelled due to the method of business operating of new owners is relatively small and amounts around 10%. Nevertheless, a number of enterprises in which even after implemented privatization there was no visible improvement of performances is considerably higher, which emphasizes opposition of the management and employed in up to now non-privatized enterprises.

In Serbia practically everybody speaks in favor of privatization, but new owners bother almost everybody. For many people, privatization by multinational foreign companies presents sale of national property ("family silver"). Even more undesirable are domestic private, especially substantial entrepreneurs (Delta M, MK Commerce, East Point...). Although it have been exposed that the privatization by multinational companies, and even large domestic entrepreneurs by rule, in middle term, brings to an increase of efficiency of economic operating and raising the competitiveness and volume of operating (e.g. "USS Serbia", "VB" Sevojno, "Juhor" Jagodina) almost all serious strategic investors are subject to numerous criticisms and demands for revision of purchases done. A concept of workers' shareholding, at one time applied, was abandoned in Serbia (which was incorporated in legal provisions until July, 2001) and it is clear that overall consensus has not been realized in regard of existing concept of privatization, in particular when new owners are considered. In addition, negative examples of behavior of some new owners do not contribute to overcoming the opposition to privatization and restructuring process.

Negative effect on employment presents key problem in the implementation of the process privatization and restructuring. The number of employed drop in Serbia from 2.1 million in 2001 to 1.99 million in June 2008. Namely, as a consequence of the process of privatization and enterprises restructuring, the number lay off workers increased. That in combination of low level economic activity and still insufficiently incentive measures for small and middle enterprises development, influences on high unemployment rate in Serbia.

The number of unemployed in Serbia is very high and presents one of the greatest economic and social problems. During the implementation of privatization and restructuring the number of unemployed has increased for around 200 thousands up to 2006. Starting from 2007 the number of unemployed has a decreasing tendency and according to available data for the end of 2008, the number of unemployed amounted 756 thousands persons. Unfortunately, the unemployment rate has the level of around 18.1% according to survey on labor and is the highest in region.

The results of privatization of the banking sector in the Serbia

The main weaknesses of banking system in the period before 2000. were: illiquidity and general insolvency, the lack of confidence towards financial institutions, inadequate legal environment, and/or common practice of not following the legal procedure, the lack of stable deposit bank, non-performing loans.

As a result, one of the priorities of the revitalization strategy was to create the modern and efficient financial system. The priority was to rehabilitate the banking sector as a key driver of Serbian financial system, due to the fact that non banking institutions represented only 10% of overall financial system

balance sheet. After voluntary pension funds, investment funds and leasing companies emerged and following the insurance sector development, non banking institutions increased their share to 25% of overall financial system balance sheet.

Foreign banks penetrated Serbian market either by establishing the new banks or by taking over the existing domestic bank resulting in ownership structure of Serbian banking sector to be predominantly foreign owned. In relatively short period foreign owned banks significantly increased their market share.

As at 30 June 2008, banks in majority foreign ownership accounted for RSD 1,236.4 billion or 75.0%, banks in the majority ownership of the Republic of Serbia for RSD 263.2 billion or 15.9%, and banks in majority private ownership for RSD 149.4 billion or 9.1%, of the banking sector balance sheet total. In late June 2008, the overall banking network included a total of 2,564 business units, branches, branch offices, teller units, agencies and exchange bureaus. Total banking-sector employment in Serbia was 31,331.

Table 4. The ownership structure of the banking sector at the end of June 2008

End of period	No. of banks	State owned banks		Privately owned banks			
				Private owned domestic banks		Foreign owned banks	
		No.	Share (%)	No.	Share (%)	No.	Share (%)
2002	50	23	49.4	15	23.6	12	27
2003	47	17	46.7	19	30.4	11	22.9
2004	43	14	36.1	18	26.2	11	37.7
2005	41	11	26.1	12	10.6	18	63.3
2006	37	8	14.9	7	6.5	22	78.6
2007	35	8	15.7	6	8.8	21	75.5
2008*	34	8	15.9	6	9.1	20	75.0

Source: NBS (Annual and Quarterly Reports - various issues); * end of June

Interest rates on Serbian market are significantly higher than rates in European Union countries due to several factors, but we observe the trend of their decrease since the beginning of transition. The trend of constant decrease of interest rates is the best evidence of the benefits of privatization and banking sector restructuring.

Table 5. Weighted average active 12m interest rates (as %)

Year	2000	2001	2002	2003	2004	2005	2006	2007
Interest rate	77.90	32.52	19.16	14.81	14.59	14.41	15.88	11.13

Source: NBS (Statistical Bulletin)

Simultaneously with a decrease of active banking interest rates and interest rate spreads, we observe increase in passive banking interest rates on domestic and foreign currency denominated deposits.

Finally, we have to emphasize the fact that in last few years we observe the banking sector to be profitable, liquid and highly capitalized, enabling banks to be more resistant to risks and actual global financial crisis.

Instead of conclusion

The privatization (and restructuring) of enterprises is not the aim by itself, but means for improvement of performances of business operating of the real sector and entire economy. That should result with an increase of production volume, export, then decrease of inflationary pressures, inflow of foreign in-

vestments, and increase in wages of the employed, etc. Although relatively satisfactory results of key macro economic trends in Serbia have been realized in previous period, it could not be stated that all expected effects efficiently have been realized up to now. Furthermore, as it could be seen from the data on Global competitiveness indicators, the Serbian economy has not yet reached the satisfactory level of competitiveness. It is, according to the World Economic Forum report, on 91 places among 130 countries.

The restructuring is often "painful" process followed by some undesirable effects, which includes leaving certain productions, "cutting" of the number of employees and closing numerous non-propulsive enterprises or their parts, the privatization and restructuring of the firms in real sector of the economy of Serbia is inevitable. Although processes of privatization and restructuring had initially negative effect in transition countries (so called transitional crisis), the economies characterized by intensive privatization and restructuring processes come faster out of the crisis and realize faster economic growth. Namely, the sooner it comes to change in economic structure and changes in a method of operating of the real economy and financial sector, the sooner are realized assumptions for faster and sustainable economic growth, improvement of competitiveness and increase of export, living standard, and even growth of employment. All that indicates to necessity of implementation intensive processes of privatization and restructuring, regarding the fact that with archaic economic structure and obsolete method of business operating successful results of business operating cannot be achieved.

Privatization and restructuring of banking sector had substantial positive impact on the stability and efficiency of the financial system, and contributed largely to decrease of active banking interest rates and interest rate spreads followed by increase of passive banking interest rates on domestic and foreign currency denominated deposits. We believe that marked trends, resulting from the increased competitiveness and efficiency of banking sector, are confirming the benefits of privatization and banking sector restructuring.

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